

Message Text

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TO SECSTATE WASHDC 9226
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SUBJ: MAJOR PROJECT - SIDERBRAS STAGE III STEEL EXPANSION PROGRAM

REF: RIO DE JANEIRO 3437

FOLLOWING TELEGRAM DRAFTED BY AMCONGEN RIO DE JANEIRO.

1. SUMMARY: THE BRAZILIAN GOVERNMENT, THROUGH THE STATE-OWNED STEEL HOLDING COMPANY SIDERBRAS, IS STRUGGLING TO MAINTAIN ITS AMBITIOUS STAGE III STEEL EXPANSION PROGRAM ON TRACK. STAGE III, WHICH ORIGINALLY ENVISIONED AN OVERALL INCREASE IN STEEL PRODUCTION OF MORE THAN 4 MILLION METRIC TONS PER YEAR (MMTY) AT THE THREE MAJOR SIDERBRAS PLANTS - COMPANHIA SIDERURGICA NACIONAL (CSN), COMPANHIA SIDERURGICA PAULISTA (COSIPA), AND USINAS SIDERURGICAS MINAS GERAIS (USIMINAS) (FROM 7.2 MMTY IN 1976/7 TO 11.6 MMTY BY 1979/80) HAS SUFFERED A SERIES OF REVERSES IN RECENT MONTHS WHICH ARE LIKELY TO SLOW UP BRAZIL'S STEEL EXPANSION TIMETABLE AND HAVE ALREADY RESULTED IN SOME MODIFICATIONS IN STAGE III PROGRAMS, LEADING TO A SMALLER INCREASE

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IN PROJECTED STEEL OUTPUT THAN ORIGINALLY PLANNED (DOWN AT LEAST 0.6 MMTY FROM EARLIER ESTIMATES). THESE DIFFICULTIES ARE LARGELY CENTERED AROUND THE PROBLEM OF GENERATING ADEQUATE FUNDS TO MEET THE SIZEABLE FINANCIAL COMMITMENTS UNDERTAKEN IN CONNECTION WITH THE THREE COMPANIES' STAGE III EXPANSION PROGRAMS. HOWEVER, A MAJOR OVERSEAS LENDER - THE INTER-

NATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (IBRD), WHICH HAD SHOWN INCREASING CONCERN OVER STAGE III FINANCING (INTER ALIA), HAS APPARENTLY BEEN SATISFIED BY BRAZILIAN GOVERNMENT ASSURANCES THAT A MORE CAREFULLY CONCEIVED AND ADMINISTERED - AND ADEQUATELY FINANCED - STEEL EXPANSION PROGRAM WILL RESULT FROM NEW GOVERNMENT MEASURES DESIGNED TO RESOLVE STAGE III DIFFICULTIES. BY NOVEMBER, CONTRACTS FOR STAGE III EQUIPMENT HAD BEEN SIGNED TOTALLING SLIGHTLY OVER \$600 MILLION. IN ADDITION, TECHNICAL AND COMMERCIAL PROPOSALS HAVE BEEN OPENED FOR 280 (OUT OF A TOTAL OF 451) INDIVIDUAL EQUIPMENT BIDDING "PACKAGES".
END SUMMARY.

2. BACKGROUND. OVER THE LAST FOUR MONTHS, STAGE III - AND TO A LESSER EXTENT, THE NEARLY COMPLETED STAGE II - OF BRAZIL'S AMBITIOUS 4-STAGE STEEL EXPANSION PROGRAM, ORIGINALLY DESIGNED TO MORE THAN TRIPLE TOTAL BRAZILIAN STEEL PRODUCTION IN THE 1970-1980 PERIOD, HAS BEEN CONFRONTED WITH A NUMBER OF SERIOUS PROBLEMS, LARGELY (BUT NOT EXCLUSIVELY) CENTERED AROUND THE PROBLEM OF INADEQUATE FUNDS AVAILABLE TO MEET FINANCIAL COMMITMENTS. IN EARLY SEPTEMBER, AT ABOUT THE SAME TIME AN IBRD REPORT WAS RELEASED SEVERELY CRITICISING STAGE II EXPANSION PROGRAMS AT CSN, BRAZIL'S (AND LATIN AMERICA'S) FIRST AND STILL LARGEST STEEL PLANT, A DRASTIC MANAGEMENT SHAKEUP TOOK PLACE AT THAT SAME COMPANY (SEE REFTEL). SOON THEREAFTER, INDUSTRY SOURCES, AS WELL AS PRESS REPORTS, SUGGESTED THAT A SECOND GOVERNMENT-OWNED MAJOR STEEL COMPANY (COSIPA) WAS ALSO EXPERIENCING DIFFICULTIES WITH ITS EXPANSION PLANS (STAGE III, IN THIS CASE), WITH ONLY ONE COMPANY INVOLVED IN THE EXPANSION PROCESS (USIMINAS) APPARENTLY PROCEEDING WITH ITS DEVELOPMENT PROGRAM MORE OR LESS ON SCHEDULE. SUBSEQUENT IBRD VISITS HAVE KEPT THE STAGE II/III EXPANSION LIMITED OFFICIAL USE

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PROGRAMS IN THE HEADLINES, AND IN SPITE OF OFFICIAL BRAZILIAN DENIALS, HAVE TENDED TO CONFIRM AN INDUSTRY VIEW THAT BOTH CSN AND COSIPA WERE BEING FORCED TO MODIFY THEIR STAGE III PLANS IN ORDER TO SATISFY IBRD-IMPOSED REQUIREMENTS.

3. THROUGHOUT THE SEPTEMBER-NOVEMBER PERIOD, INTENSIVE DISCUSSIONS WERE CARRIED OUT IN GOVERNMENT AND INDUSTRY CIRCLES - AND IN THE PRESS - CONCERNING THOSE MEASURES NECESSARY TO ENSURE A RATE OF PROGRESS ON STAGE III ACCEPTABLE TO BOTH THE BRAZILIAN SIDE AND THE IBRD. FINANCING FOR THE THREE STEEL COMPANIES WAS THE KEY TOPIC MOST OFTEN DISCUSSED DURING THIS WIDE-RANGING DEBATE, WITH A NUMBER OF MEANS SUGGESTED TO ENSURE AN ADEQUATE SUPPLY OF FUNDS FOR STAGE III PROGRAMS. THESE MEASURES INCLUDED: (1) THE PURCHASE OF SIDERBRAS SHARES BY OTHER BRAZILIAN GOVERNMENT OR GOVERNMENT-CONTROLLED ENTITIES (SUCH AS THE BANCO DO BRASIL, AND THE STATE-OWNED OIL COMPANY, PETROBRAS, ETC.); (2) SIZEABLE TAX EXEMPTIONS AND REDUCTIONS; (3) THE CREATION OF A "NATIONAL FUND", INCLUDING FEDERAL AND STATE GOVERNMENT PARTICIPATION,

IN ORDER TO MAKE ADDITIONAL FINANCING AVAILABLE TO THE STEEL INDUSTRY; (4) THE NEGOTIATION OF ADDITIONAL OVERSEAS LOANS (CURRENTLY UNDERWAY IN LONDON, WITH A TOTAL OF \$350 MILLION ALREADY OBTAINED) AND (5) A HIKE IN THE DOMESTIC PRICE OF STEEL (6 PC IS THE FIGURE MOST OFTEN USED). END BACKGROUND.

4. IN SPITE OF THE APPARENT DIFFICULTIES CSN AND COSIPA HAVE EXPERIENCED IN TERMINATING STAGE II EXPANSION PROGRAMS AND BEGINNING STAGE III, GOVERNMENT SOURCES HAVE CONSISTENTLY MAINTAINED - BOTH OFFICIALLY AND UNOFFICIALLY - THAT THESE DIFFICULTIES WOULD CAUSE ONLY MINIMAL DISRUPTIONS OF STAGE III EXPANSION PLANS, THROUGH THEY HAVE ACKNOWLEDGED THAT SIGNIFICANT

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RESOURCES WOULD HAVE TO BE SHIFTED FROM STAGE IV PROGRAMS TO MEET THE INCREASED FINANCIAL DEMANDS OF STAGE III. IN THAT CONNECTION, THE RECENTLY-ANNOUNCED 1977 BUDGET FOR THE STEEL INDUSTRY - ABOUT \$1.7 BILLION - VIRTUALLY ELIMINATES STAGE IV FUNDING BUT (ACCORDING TO GOVERNMENT SOURCES) IS FULLY ADEQUATE TO MEET THE REQUIREMENTS OF STAGE II AND III PROGRAMS. AT THE SAME TIME, THESE AUTHORITIES HAVE STRESSED THAT BRAZIL WILL CONTINUE TO RELY ON NATIONAL SOURCES OF SUPPLY FOR A HIGH PERCENTAGE OF STEEL EXPANSION PROGRAM EQUIPMENT REQUIREMENTS, ALTHOUGH TACITLY ACKNOWLEDGING THAT SUCH REQUIREMENTS HAVE LED TO BOTH INCREASED COSTS AND LENGTHY DELAYS IN THE PAST.

5. AS OF EARLY DECEMBER, OVERALL PROGRESS ON STAGE III PROGRAMS

CAN BE SUMMARIZED AS FOLLOWS:

USIMINAS - CONTRACTS SIGNED FOR THE SUPPLY OF STAGE III EQUIPMENT AND MACHINERY TALLING \$326 MILLION; COSIPA - \$290 MILLION; WHILE CSN HAS NOT YET SIGNED ANY EQUIPMENT CONTRACTS, THOUGH SEVERAL MAJOR BIDS HAVE BEEN AWARDED AND 69 TECHNICAL AND COMMERCIAL PROPOSALS HAVE BEEN OPENED. FYI: A DETAILED LISTING AND CURRENT STATUS REPORT ON THE 451 INDIVIDUAL BID PACKAGES HAS LIMITED OFFICIAL USE

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BEEN REQUESTED FROM SIDERBRAS AND THE THREE COMPANIES INVOLVED, AND, IF OBTAINABLE, WILL BE FORWARDED BY AIRGRAM.)

6. AS A RESULT OF STAGE II EXPANSION PROTRAMS, NOW LARGELY COMPLETED AT THE THREE MAJOR GOVERNMENT-OWNED STEEL COMPANIES, THEIR INSTALLED CAPACITIES WILL BE: CSN - 2.5 MMTY (TO BE OBTAINED BY EARLY 1977, WHEN ITS NEW BASIC OXYGEN FURNACE IS OPERATING AT FULL CAPACITY; COSIPA - 2.5 MMTY (BY MID-1977), AND USIMINIS - 2.4 MMTY. BY COMPLETION OF STAGE III (OFFICIALLY ESTIMATED TO OCCUR BY 1979-80), CAPACITY AT THE THREE COMPANIES IS NOW PROJECTED TO INCREASE BY AN AGGREGATE OF 3.8 MMTY, REACHING THE FOLLOWING TOTALS: CSN - 4.0 MMTY (DOWN BY 0.6 MMTY FROM EARLY PROJECTIONS); COSIPA - 3.5 MMTY, AND USIMINAS - 3.5 MMTY.

7. ON BALANCE, 1976 HAS NOT BEEN A PARTICULARLY SUCCESSFUL YEAR FOR THE BRAZILIAN STEEL INDUSTRY, ESPECIALLY AS FAR AS ITS STAGE II AND II EXPANSION PROGRAMS ARE CONCERNED. LARGELY BECAUSE OF DELAYS IN COMPLETING STAGE II PROJECTS - PARTICULARLY AT CSN - AND AN EXPLOSION AND FIRE AT ONE OF COSIPA'S BASIC OXYGEN FURNACES, TOTAL BRAZILIAN STEEL PRODUCTION FOR 1976 (ESTIMATED AT BETWEEN 9.2 AND 9.5 MMTY) WILL BE UP BY ABOUT 11-15 PC OVER 1975, BUT DOWN OVER 20 PERCENT FROM PROJECTIONS MADE AT THE BEGINNING OF THE YEAR. (FYI: TO GIVE SOME IDEA OF THE MAGNITUDE OF THE STAGE III AND IV EFFORTS WHICH WILL BE REQUIRED TO MEET EVENTUAL STEEL PRODUCTION TARGETS, AT A ROUGH EXTRAPOLATION OF THE 1976 RATE OF INCREASE, BRAZILIAN STEEL PRODUCTION IN 1985 - 21-27 MMTY - WOULD FALL SUBSTANTIALLY SHORT OF THE ORIGINAL GOAL OF 42 MMTY AND ABOUT 5-10 MMTY BELOW A MORE RECENTLY-ANNOUNCED TARGET OF 31-33 MMTY.

8. IN ADDITION, DIFFICULTIES ENCOUNTERED WITH THE COMPLETION OF STAGE II AND INITIATION OF STAGE III EXPANSION PROGRAMS HAVE CONTRIBUTED TO A MOOD OF UNCERTAINTY REGARDING THE PROSPECTS FOR SUCCESSFUL COMPLETION OF STAGE III PROGRAMS AT A COST FIGURE AND DATE ROUGHLY APPROACHING EARLIER ESTIMATES. THESE DIFFICULTIES HAVE INCLUDED: SUSTAINED - BUT EVENTUALLY RETRACTED - LIMITED OFFICIAL USE

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ALLEGATIONS FROM ONE UNSUCCESSFUL BIDDER (VILLARES) CONCERNING THE "IMPROPER" AWARDING OF AHOT STRIP MILL CONTRACT (AT CSN); PROBLEMS ENCOUNTERED IN SATISFYING IBRD REQUIREMENTS, INCLUDING PRESSURE FROM THE LATTER TO TRIM EXPANSION PROGRAMS; AND SIGNIFICANT PRESS AND PRIVATE INDUSTRY CRITICISM OF GOVERNMENT-DIRECTED STEEL EXPANSION PROGRAMS GENERALLY. (FYI: AT YEAR'S END, STAGE IV WAS NOT YET REALLY A TOPIC OF DETAILED DISCUSSION, EXCEPT AS A SOURCE OF REDIRECTED FUNDS FOR STAGE III PROGRAMS ; ITS INITIATION HAS BEEN POSTPONED TO AT LEAST 1978).

9. COMMENTS: BRAZIL'S DIFFICULTIES IN CARRYING OUT AN EXTREMELY AMBITIOUS STEEL EXPANSION PROGRAM - PROBABLY UNIQUE IN THE FREE WORLD IN SIZE AND TIMING - HAVE NOT BEEN UNEXPECTED, GIVEN THE MAGNITUDE OF THE TASKS INVOLVED. HOWEVER, IN SPITE OF PUBLIC ASSURANCES TO THE CONTRARY - I.E. THAT STAGE III IS, IN FACT, PROCEEDING MORE-OR-LESS NORMALLY - THE BRAZILIAN GOVERNMENT (THROUGH SIDERBRAS) HAS MADE ADJUSTMENTS IN BOTH THE SCOPE AND TIMING OF STAGE III PROGRAMS IN ORDER TO ACCOMMODATE THE REQUIREMENTS EFFECTIVELY IMPOSED ON THEM BY THEIR RELIANCE ON OVERSEAS LENDERS, PARTICULARLY THE IBRD. (CERTAIN OF THESE CORRECTIVE ACTIONS WOULD PROBABLY HAVE BEEN TAKEN WITHOUT IBRD PRODDING, ALTHOUGH THERE WOULD NO DOUBT HAVE BEEN MUCH LESS PUBLIC DISCUSSION OF STAGE II AND III DIFFICULTIES HAD IBRD CRITICISM NOT REACHED THE PRESS.) THE EXTENT TO WHICH FURTHER DELAYS AND/OR MODIFICATIONS IN STAGE III PROGRAMS WILL BE REQUIRED IS NOT COMPLETELY CLEAR, BUT AT LEAST SOME ADDITIONAL SLOW-DOWN AND DECREASE IN PRODUCTION TARGETS MAY BE NECESSARY.

10. ON BALANCE, HOWEVER, IT SEEMS LIKELY THAT THE BRAZILIAN GOVERNMENT WILL TAKE WHATEVER STEPS ARE NECESSARY TO ENSURE THAT MORE-OR-LESS ADEQUATE FINANCIAL RESOURCES ARE MADE AVAILABLE FOR STAGE III, BOTH IN ORDER TO SATISFY THE IBRD AND TO MAINTAIN EXPANSION MOMENTUM IN THE PRIORITY STEEL SECTOR. ASIDE FROM NEGOTIATING NEW OVERSEAS LOANS, THIS WILL PROBABLY BE LARGELY

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ACCOMPLISHED BY EFFECTIVELY TRANSFERRING FUNDS FROM OTHER GOVERNMENT-OWNED OR CONTROLLED ENTITIES OR SECTORS TO THE THREE STEEL COMPANIES (VIA STOCK PURCHASES, TAX REBATES, GOVERNMENT GUARANTEED LOANS, ETC.) IN ORDER TO MEET IBRD AND OTHER REQUIREMENTS. ON DEC 14, IT WAS ANNOUNCED THAT THE NATIONAL DEVELOPMENT BANK (BNDE) WAS GOING TO ACQUIRE CR\$ 1 BILLION OF SIDERBRAS EQUITY. THE GOVERNMENT WILL ATTEMPT TO (APPROXIMATELY) FOLLOW THE INITIAL STAGE III TIMETABLE, WITH A DELAY OF PERHAPS 2 YEARS IN COMPLETING THIS STAGE AND A POSSIBLE SHORTFALL OF 0.6 TO 1.4 MMTY IN PLANNED STEEL OUTPUT, AS COMPARED TO EARLIER STAGE III GOALS.

11. THOUGH SUCH A MOVE COULD RESULT IN THE GENERATION OF A SIGNIFICANT AMOUNT OF NEW FINANCING FROM WITHIN THE THREE STEEL COMPANIES, THE BRAZILIAN GOVERNMENT PROBABLY WILL NOT ALLOW THE PRICE OF STEEL TO RISE TOO SHARPLY, FEARING THE OVERALL INFLATIONARY EFFECTS OF HIGHER STEEL PRICES. RATHER, IT IS LIKELY TO CONTINUE THE POLICY OF ADMINISTERED, SLOWLY INCREASING PRICES, LARGELY RELYING ON A SIZEABLE RE-ALLOCATION OR TRANSFER OF RESOURCES FROM WITHIN THE GOVERNMENTAL SECTOR - INSTEAD OF THE PRICE MECHANISM - TO ADEQUATELY COPE WITH THE STEEL INDUSTRY'S LIMITED OFFICIAL USE

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INCREASING FINANCIAL REQUIREMENTS (THE BASIC CAUSE FOR DIFFICULTIES IN IMPLEMENTING STAGE III EXPANSION PROGRAMS; OTHER PROBLEMS INCLUDE POOR ADMINISTRATION, AND LATE EQUIPMENT DELIVERY BY NATIONAL SUPPLIERS).

12. IN SHORT, THE BRAZILIAN GOVERNMENT APPEARS TO HAVE DECIDED THAT THE OVERALL IMPORTANCE OF THE NATION'S STEEL SECTOR IS OF SUCH MAGNITUDE THAT IT MUST TAKE WHATEVER STEPS ARE NECESSARY TO ENSURE THAT ITS STAGE III STEEL PRODUCTION GOALS ARE LARGELY ATTAINED, WITH WHAT ARE CONSIDERED TO BE ONLY MODERATE DELAYS. GIVEN THIS ATTITUDE AND THE MAGNITUDE OF THE RESOURCES AVAILABLE TO IT, BRAZIL COULD ACCOMPLISH THIS GOAL, AND MAY IN FACT BE ABLE TO ATTAIN STEEL SELF-SUFFICIENCY BY 1982/3 (INSTEAD OF AN EARLIER TARGET OF 1980) AND COMPLETION OF A SOMEWHAT DIMINISHED STAGE III BY 1981/2, RATHER THAN BY 1979/80, AS INITIALLY PLANNED. END COMMENTS. CRIMMINS

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